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ARTICLES

CONSTITUTIONAL MOMENTS, PRECOMMITMENT, AND FUNDAMENTAL REFORM: THE CASE OF ARGENTINA

GEOFFREY P. MILLER*

I. INTRODUCTION

For millions of Argentines who straggled into the voting booths from rain-drenched streets on May 14, 1989, the prospects for the future could hardly have looked drearier. The outgoing President, Radical Party leader Raúl Alfonsín, had guided the country toward a stable democracy. But, despite enormous efforts, Alfonsín's economic policies proved disastrous. Hyperinflation gripped the economy.¹ Argentina's enormous foreign debt was in default.² Gross domestic product was decreasing and purchasing power evaporating. The nation was falling into the Third World, even as other Latin-American countries—Chile, for example—surged toward prosperity. Fairly or not, Radical Party presidential candidate Eduardo Angeloz bore the onus for the catastrophe.

Even so, the other major candidate, Rioja Province Governor Carlos Saul Menem, offered little improvement. Menem's Peronist Party had been a principal sponsor of Argentina's ruinous experiment with statist economic

* Kirkland & Ellis Professor, University of Chicago Law School. I would like to thank the many Argentines who generously consented to be interviewed or otherwise assisted in this project, including Julio Alsogaray, Ricardo Anglés, Dr. Miguel A. Balestrini, Javier A. Bolzico, Juan J. Bruchou, Omar C. Crillo, Maria Elena Deligiannis, Cesar A. Deymonnaz, Dr. Roberto Domenech, Dr. Roberto Domínguez, Eduardo J. Fasulino, Roque Fernández, Javier González Fraga, José María Ibarbia, Enrique J. Loncán, Roque Maccarone, Dr. José Luis Machinea, Dr. Augusto C. Magliano, Facundo Gómez Minujín, Raul Passano, Norberto Carlos Peruzzotti, Ignacio J. Carlos Premoli, Gonzalo Sánchez Sorondo, Osvaldo J. Ventura, and Alfredo M. Vitolo. I would also like to thank Roberto Gangarella, Dr. Augusto C. Magliano and Liliana Schumacher for their comments and Ricardo Maldonado for his valuable research assistance.

1. See *infra* notes 33-40 and accompanying text.

2. See Menem Calls for "Major Surgery" to Economy, LATIN AM. REGIONAL REP.: S. CONE (Latin Am. Newsl., Ltd.), Aug. 3, 1989, available in LEXIS, Nexis Library, Nwlrts File. By 1989, Argentina's foreign debt exceeded 100 percent of GDP. INTER-AMERICAN DEVELOPMENT BANK, ECONOMIC AND SOCIAL PROGRESS IN LATIN AMERICA, 1991 REPORT 24 (1992).

policies.³ His campaign platform was hardly reassuring: he promised a "productive revolution" but endorsed inflationary wage increases.⁴ His ardent nationalism did not augur well for the future integration of Argentina into the world economy.⁵ Additionally, his party's prior opposition to privatization did not suggest that fundamental reform would be forthcoming in the state sector.⁶

This was the first election in six decades in which one democratically elected regime stood ready to relinquish power peacefully to another.⁷ But doubt pervaded even here. Alfonsín had survived, but military revolts threatened his grip.⁸ The military could easily launch another coup. Many Argentines believed that only strong and authoritative rule could return the nation to a semblance of economic stability.⁹

Menem won this most inauspicious of elections with 48.9% of the vote compared to 37% for Angeloz.¹⁰ Then came the revolution.

Taking power five months early in the midst of complete economic

3. For an excellent discussion of the Peronist program during the 1940s and 1950s, see PAUL H. LEWIS, *THE CRISIS OF ARGENTINE CAPITALISM* 129-244 (1990).

4. See WILLIAM RATLIFF & ROGER FONTAINE, *CHANGING COURSE: THE CAPITALIST REVOLUTION IN ARGENTINA* 34 (1990).

5. For a discussion of Menem's nationalism, see *Argentina and Brazil Seek "Synergy,"* LATIN AM. REGIONAL REP.: S. CONE (Latin Am. Newsl., Ltd.), Oct. 5, 1989, available in LEXIS, Nexis Library, Nwltrs File.

6. See *Menem Calls for "Major Surgery" to Economy,* *supra* note 2 (discussing Peronist opposition to privatization proposals prior to 1989 election).

7. See *Argentina Breaks with the Past,* LATIN AM. REGIONAL REP.: S. CONE (Latin Am. Newsl., Ltd.) Dec. 21, 1989, available in LEXIS, Nexis Library, Nwltrs File; Alejandro Garro, *Nine Years of Transition to Democracy in Argentina: Partial Failure or Qualified Success?*, 31 COLUM. J. TRANSNAT'L L. 1 (1993). Since 1946, Argentina has been ruled by military juntas on three occasions: 1955-58, 1966-73, and 1976-83. See SUSAN CALVERT & PETER CALVERT, *ARGENTINA: POLITICAL CULTURE AND INSTABILITY* xiii-xiv (1989). Even periods that were ostensibly democratic were often marred by intimidation and fraud. See Edward C. Epstein, *Democracy in Argentina*, in *THE NEW ARGENTINE DEMOCRACY: THE SEARCH FOR A SUCCESSFUL FORMULA* 3, 3 (Edward C. Epstein ed., 1992); Alejandro Garro, *supra*.

8. Military insurrections occurred in April 1987, January 1988, December 1988, and December 1990. See Epstein, *supra* note 7, at 1.

9. For a discussion of the authoritarian strain in Argentine politics, see WILLIAM C. SMITH, *AUTHORITARIANISM AND THE CRISIS OF ARGENTINE POLITICAL ECONOMY* (1989).

10. *Recent Political Developments*, Country Credit Risk Service, October 1, 1989, available in LEXIS, World Library, ECOSVC file. The only other major voting bloc went to the conservative minor party UCeDé, with 6.7%. See RATLIFF & FONTAINE, *supra* note 4, at 34. The Peronist Party thus returned to power in Argentina for the first time since March 1976, when a military coup removed from office General Perón's third wife, the unfortunate Isabel. See *Recent Political Developments*, Country Credit Risk Service, July 31, 1989, available in LEXIS, World Library, ECOSVC file.

collapse, Menem privatized state industries,¹¹ instituted important reforms to the system of bank regulation,¹² eliminated trade barriers, and restructured the tax system. He also negotiated a settlement of the nation's external debt, controlled inflation by pegging the local currency to the U.S. dollar, worked toward resolving the dispute with Great Britain over the Malvinas (Falkland) Islands, and rehabilitated his country's reputation in the world financial community.

These recent events in an important Latin American country raise fundamental issues of political science and law which are of interest to the analysis of any political system. In this Article, I will consider how Argentina has addressed two universal problems: effecting fundamental reform in the presence of powerful vested interests and precommitting to restrain undesirable behavior by the government in the face of political pressures for short-term solutions.

The problem of effecting fundamental reform in the presence of vested special interests is central to the work of scholars such as Bruce Ackerman,¹³ Cass Sunstein,¹⁴ and Mancur Olson.¹⁵ In the case of Argentina, the power of interest groups has been particularly troubling because the political system has been so heavily dominated by organized groups—industrial workers, large farmers, industrialists, domestic banks, foreign banks, the military, the Catholic Church, and others. The government's role has been reduced at times to that of a broker among competing interest group claimants. Such a political system would not appear conducive to fundamental reform. Yet, reform did occur, and it occurred peacefully through the ballot box and through market changes rather than through coup or insurrection.

Fundamental change was possible because Argentina experienced in 1989-91 the kind of constitutional moment that occurred in the United

11. See *Sponsorship Statement—Commitment to Privatization*, INSTITUTIONAL INVESTOR, Oct. 31, 1991, available in LEXIS, World Library, TXTLNE file.

12. See Geoffrey P. Miller, *Politics of Deposit Insurance Reform: the Case of Argentina*, in PROCEEDINGS OF A CONFERENCE ON BANK STRUCTURE AND COMPETITION (Federal Reserve Bank of Chicago ed., forthcoming 1993).

13. See, e.g., BRUCE A. ACKERMAN, *WE THE PEOPLE: FOUNDATIONS* (1991); Bruce A. Ackerman, *Constitutional Politics/Constitutional Law*, 99 YALE L.J. 453 (1989); Bruce A. Ackerman, *The Storrs Lectures: Discovering the Constitution*, 93 YALE L.J. 1013 (1984) [hereinafter Ackerman, *Storrs Lectures*].

14. See, e.g., Cass R. Sunstein, *Interest Groups and American Public Law*, 38 STAN. L. REV. 29 (1985); Cass R. Sunstein, *Constitutionalism after the New Deal*, 101 HARV. L. REV. 421 (1987).

15. See, e.g., MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS: ECONOMIC GROWTH, STAGFLATION, AND SOCIAL RIGIDITIES* (1982).

States during times such as the framing of the Constitution, the Reconstruction Period, and the New Deal—a period in which ordinary, interest group-dominated politics gives way to a different political environment in which fundamental reforms are possible.¹⁶

As with most constitutional moments, Argentina's grew out of a national crisis. By 1989-91, Argentina had descended into a state of complete collapse.¹⁷ Even for a country inured to instability, the crisis was unparalleled. As a result, the public reached a remarkable consensus both as to the causes of the fiasco and the necessary remedies. The causes were an unstable political system vulnerable to seizures of power by authoritarian regimes, a bloated state sector that had sapped the nation's economic vitality for generations, and the inability of the political system to resist powerful interest groups seeking state subsidies. The remedies were democratic elections, reduction of the public sector, privatization of state-owned industries, and creation of structures of government capable of exercising fiscal and monetary restraint. There was surprisingly little political opposition to the basic elements of Menem's program. In fact, the opposition Radical Party has sometimes claimed that Menem is simply implementing programs that they conceived.¹⁸

A second basic question of political science and law—which is fundamental to the work of scholars such as Jon Elster,¹⁹ Stephen Holmes,²⁰ Paul Kahn,²¹ and others—is that of strategies of precommitment. How can a political system provide reliable assurances that it will act in the public interest? Are there ways that a political system can, like Ulysses, tie itself to the mast in order to navigate the seas of self-government without answering the siren call of short term, self-interested policies?²² Argentina, simply because it has been unusually prone to short term strategies adopted by politicians serving as temporary guardians of the government, provides an excellent test case for this problem. The need to

16. As Bruce Ackerman has argued, a constitutional moment can occur even if the constitution itself is not amended. See Ackerman, *Storrs Lectures*, *supra* note 13.

17. One perceptive Argentine observer refers to this period as a "break in history." Interview with Dr. Augusto Magliano, (Dec. 1992) [hereinafter Magliano Interview].

18. See Bill Hinchberger, *Argentina: Economy Minister Cavallo—Master of Reform*, INSTITUTIONAL INVESTOR, May 30, 1992.

19. JON ELSTER, *ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY* (1979).

20. Stephen Holmes, *Gag Rules or the Politics of Omission*, in CONSTITUTIONALISM AND DEMOCRACY 19 (Jon Elster & Rune Slagstad eds., 1989).

21. Paul W. Kahn, *Reason and Will in the Origins of American Constitutionalism*, 98 YALE L.J. 449 (1989).

22. See ELSTER, *supra* note 19.

adopt policies that could persuade the people of Argentina, Argentina's international creditors, and the world at large that Argentina would resist short-term pressures in the future is thus a compelling feature of Argentina's ongoing search for political and economic stability.

In the United States, the problem of precommitment is typically seen as one of constitutional law: matters deemed too fundamental to be subject to the short-term play of public opinion or interest group politics are elevated to constitutional norms—norms which can be altered or repealed only through the extraordinary procedures of constitutional change. In Argentina, however, constitutional reform was not a serious option. Argentina's Constitution and Supreme Court have proven ineffectual at preventing unconstitutional actions by past governments and were not equal to the task of ensuring that the reforms of 1989-91 would be an enduring part of the political system.

Argentina chose a different approach to precommitment. First, it restricted its own behavior by legislation. Congress established the central bank's independence while simultaneously denying it the power to bail out bank depositors or lend to the government. Second, and equally important, the government deliberately exposed itself to serious penalties from the world financial market in the event that it failed to live up to its promises. This strategy of exposing the national throat to the teeth of market forces has provided a high degree of assurance that the government will in fact keep its promises. Lacking reliable mechanisms for constitutional precommitment, Argentina has elected to utilize the disciplines of statute law and of the marketplace to keep its short-term impulses under control.

This Article is organized as follows. Part II provides background on Argentina's general economic and political conditions. Part III offers some thoughts about the mechanisms of fundamental change and precommitment.

II. ECONOMIC AND POLITICAL BACKGROUND

Few nations in modern times have been so mismanaged, or have failed so spectacularly in achieving their potential, as the Republic of Argentina. One of the richest nations in the world at the turn of the century,²³ Argentina had descended fitfully, but seemingly inevitably, into ever greater political and economic chaos. Its governments, whether military or civilian,

23. See Alan M. Taylor, *External Dependence, Demographic Burdens, and Argentine Economic Decline after the Belle Époque*, 52 J. ECON. HIST. 907, 908 (1992). See generally DAVID G. ERRO, *RESOLVING THE ARGENTINE PARADOX: POLITICS AND DEVELOPMENT, 1966-1992* (1993); LAURA RANDALL, *AN ECONOMIC HISTORY OF ARGENTINA IN THE TWENTIETH CENTURY* (1978).

have promised much and delivered little; voiced concern for democracy while ruling by decree; and claimed to be all things to all people while, in the end, being precious little to precious few. The national culture of twentieth-century Argentina finds its fullest expression in the Tango, a combination of music, song and dance that evokes, through the plaintive strains of the bandoneón, the broken hopes and faded elegance of a world-weary Buenos Aires.

A. *Conditions Through 1989*

The roots of Argentina's decline extend far back into the nation's history, but the immediate genesis lay in policies instituted by the Peronist Party during the 1940s.²⁴ Coming to power in 1946, Juan Perón nationalized (through purchase rather than expropriation) important industries and started a process of government ownership of, or intervention in, major businesses. This governmental intervention came to be almost a defining attribute of the Argentine economic and political system. By 1990, the government owned railroads, the telecommunications system, gas and electric utilities, major banks, chemical factories, the leading petroleum manufacturer, most iron and steel manufacturers, water and sewage companies, the post office, large military industries, and more.²⁵ Many other industries which were not state-owned received subsidies or trade protections from the government. At the same time, industrial unions exercised considerable power to obtain generous wage settlements from the government and the private sector. The result was an industrial sector characterized by monopolistic or oligopolistic production, distortions introduced by tax benefits and subsidies, and insulation from international competition.²⁶

Along with state involvement in the industrial sector came a political system in which important interest groups acted as de facto partners with government agencies in brokering particular strategies and policies.²⁷ Government officials consulted major groups such as the military, manufacturers, agribusiness, domestic and foreign banks, and organized labor on a regular basis. These groups typically enjoyed a "virtually

24. For background on Perón's philosophy and rise to power, see, e.g., GARY W. WYNIA, *ARGENTINA: ILLUSIONS AND REALITIES* 37-69 (2d ed. 1992).

25. See, e.g., William C. Smith, *Hyperinflation, Macroeconomic Instability, and Neoliberal Restructuring in Democratic Argentina*, in *THE NEW ARGENTINE DEMOCRACY: THE SEARCH FOR A SUCCESSFUL FORMULA* 20, 48 (Edward C. Epstein, ed., 1992) [hereinafter Smith, *Hyperinflation*].

26. For good background on the statist model of Argentine development, see ERRO, *supra* note 23; WORLD BANK, *ARGENTINA: REFORMS FOR PRICE STABILITY AND GROWTH* 1-11 (1990).

27. See Epstein, *supra* note 7, at 13-19.

monopolistic status as the quasi-official national representative for a particular functional activity."²⁸ The role of the government, in turn, was often to mediate among these competing interest groups.

This form of corporatist representation—de facto dominance of governmental policies by major interest groups mediated by relatively weak government agencies—led to a political system in which the government disbursed subsidies to industry, wage increases to labor, and tariff protections to both. The result, predictably, was ever-increasing inefficiency in the nation's industrial sector²⁹ and chronic, corrosive inflation. When conditions became intolerable, government would announce stabilization plans accompanied by austerity measures. However, political or economic forces quickly undermined these efforts.³⁰ The country was unable to precommit reliably to undertake the necessary reforms, vibrating instead, in the words of political scientist Jon Elster, in a cycle that "begin[s] in austerity and end[s] in potlatch."³¹

The inefficiencies of the Argentine corporatist state are reflected in its economic output. As shown in Table 1, real gross domestic product (GDP) growth rates have been anemic or negative through much of the 1980s. Between 1981 and 1990, Argentina's GDP declined 1.9%, and its GDP per capita declined by 3.2%.³²

28. *Id.* at 14.

29. Because it exported on world markets, the agricultural sector operated under more competitive principles.

30. Between 1984 and 1989, the government instituted five stabilization programs—all of which failed. See WORLD BANK, *supra* note 26, at xi.

31. ELSTER, *supra* note 19, at 61.

32. INTER-AMERICAN DEVELOPMENT BANK, *supra* note 2, at 273.

TABLE 1: GROWTH (DECLINE) IN REAL GDP, 1980-89

<i>Year</i>	<i>Percent Change</i>
1980	1.5%
1981	-6.6%
1982	-4.9%
1983	3.0%
1984	2.6%
1985	-4.3%
1986	5.6%
1987	2.2%
1988	-2.7%
1989	-4.6%

Source: Inter-American Development Bank, *Economic and Social Progress in Latin America: 1990 Report* (1990).

The enormous and inefficient public sector, coupled with the extraordinary ingenuity of Argentine citizens at evading taxes, resulted in persistent budget deficits. These deficits ranged from a high of 15% of GDP in 1982 (the year of the Malvinas War) to a low of 4.9% of GDP in 1986, a year when Alfonsín's economic program enjoyed a short-lived success. These deficits are shown in Table 2.

TABLE 2: BUDGET DEFICITS AS PERCENT OF GDP, 1980-1989

<i>Year</i>	<i>Deficit</i>
1980	-7.1%
1981	-12.1%
1982	-15.0%
1983	-14.5%
1984	-11.6%
1985	-5.7%
1986	-4.9%
1987	-6.6%
1988	-9.0%
1989	-8.3%

Source: Inter-American Development Bank, *Economic and Social Progress in Latin America: 1990 Report* (1990).

The government employed two strategies to finance its deficits. First, the central bank issued money to pay claims against the government. The

result was inflation.³³ As shown in Table 3, during the 1980s, inflation rates ranged from the disastrous (by U.S. standards) to the catastrophic.

TABLE 3: CONSUMER PRICES, 1980-1989

<i>Year</i>	<i>Average Annual Increase</i>
1980	100.8%
1981	104.5%
1982	164.8%
1983	343.8%
1984	626.7%
1985	672.2%
1986	90.1%
1987	131.3%
1988	343.0%
1989	3,079.2%

Source: Inter-American Development Bank, Economic and Social Progress in Latin America: 1990 Report (1990).

Second, the government borrowed heavily on international debt markets. As shown in Table 4, Argentina's external debt more than doubled during the 1980s.

TABLE 4: ARGENTINA'S EXTERNAL DEBT, 1980-1989

<i>Year</i>	<i>Disbursed Debt (Millions \$US)</i>
1980	27,157
1981	35,657
1982	43,634
1983	45,919
1984	48,857
1985	50,947
1986	52,374
1987	58,423
1988	58,936
1989	63,314

Source: Inter-American Development Bank, Economic and Social Progress in Latin America: 1990 Report (1990).

33. See generally ENRIQUE GARCÍA VÁSQUEZ, LA ARGENTINA: CUARENTA AÑOS DE INFLACION (1988).

B. The Crisis of 1989-91

Even if the overall picture during the 1980s suggested an economy stumbling toward disaster, the catastrophe of 1989-1991 exceeded the most pessimistic expectations.

In April 1988, the government, desperately short of foreign exchange, suspended interest payments on its foreign bank debt.³⁴ Meanwhile, inflation, under some control since 1986, surged alarmingly. In July 1988, consumer prices rose a frightening 26.6%, and rates continued high in the following months.³⁵

The crisis accelerated as the nation moved toward the May 1989 elections. Alfonsín gambled that by maintaining a strong domestic currency against the dollar, he could stanch inflation and improve consumer confidence.³⁶ This policy required high interest rates on australs (the Argentine currency) and a willingness by the central bank to use its limited foreign reserves to support the exchange rate. Successful for a time, the policy was extremely perilous because investors would keep their money in australs only as long as they believed that the government would maintain the exchange rate. Everyone knew that a devaluation would come eventually.

In late January and early February 1989, the anticipated run occurred in speculative frenzy dubbed the "golpe de mercado" (coup of the market).³⁷ The central bank ran out of foreign exchange and abandoned its support for the austral. Its economic policy in ruins, the Alfonsín government ceased to exercise any vestige of monetary restraint; inflation exploded, with wholesale prices rising an astonishing 104.5% in the single month of May 1989.³⁸

The market's coup was as effective as any with guns and tanks, leading inevitably to the Radical Party's defeat. Menem captured the presidency and Peronists and their allies gained majorities in both houses of Congress.

By May 29, 1989, two weeks after the election, Argentines rioted and looted supermarkets in a spate of violence that left fifteen dead and

34. See Smith, *Hyperinflation*, *supra* note 25, at 36.

35. See *id.* at 38.

36. See *id.* at 37-38.

37. See *id.* at 39-41.

38. See *id.* at 40.

hundreds injured. This violence forced Alfonsín to declare a state of siege.³⁹ Argentina became virtually stateless. Banks and money exchanges were closed. No one knew the value of their currency, other than the fact that whatever value it had was disappearing fast. Consumer prices rocketed to amazing heights, increasing to 114.5% in June 1989 and 196.6% in July 1989.⁴⁰

So disastrous had the situation become that Alfonsín begged to leave office early. Menem donned the presidential sash in July 1989, five months before the scheduled transfer of power.⁴¹

It soon became evident that Menem, Peronist though he was, intended nothing less than a revolutionary transformation of the Argentine economy.⁴² In 1989, his government announced plans for a program as radical in its scope and ambition as any in the world, even in that extraordinary year: privatization of state-owned industries;⁴³ control of industrial unions;⁴⁴ liberalization of trade barriers; overhaul of the tax system; and elimination of virtually all government subsidies and benefits for private industry.⁴⁵

Elite economic advisors, many trained at American universities, flooded into government offices and fomented plans to undo decades of statist policies. They were carrying forward a revolution that began in Chicago and Cambridge as much as it did in Buenos Aires and Córdoba. Supporting these reforms was an important report by the World Bank entitled *Argentina: Reforms for Price Stability and Growth*.⁴⁶ Compiled by a team of experts who were in Argentina during the market coup, the report advocated comprehensive reform of monetary policy and public sector

39. See Recent Political Developments, Country Credit Risk Service, July 31, 1989, available in LEXIS, World Library, ECOSVC file; *Argentina Breaks with the Past*, *supra* note 7.

40. See Smith, *Hyperinflation*, *supra* note 25, at 40.

41. See *Argentina Breaks with the Past*, *supra* note 7.

42. For a preliminary assessment, see WYNIA, *supra* note 24, at 194-221.

43. Congress authorized the privatization program in the Reform of the State Law of August 1989. See IDB *Bullish on Argentine Outlook*, LATIN AM. REGIONAL REP.: S. CONE (Latin Am. Newsl., Ltd.) Nov. 22, 1990, available in LEXIS, Nexis Library, Nwltrs File.

44. Some powerful labor unions resisted Menem's programs, but one faction of the Confederacion General del Trabajo (CGT), the nation's umbrella congress of labor organizations, voted for pro-Menem leadership in November, 1989. See *Leadership Battle Splits the CGT*, LATIN AM. REGIONAL REP.: S. CONE (Latin Am. Newsl., Ltd.) Nov. 16, 1989, available in LEXIS, Nexis Library, Nwltrs File.

45. See generally Pablo Rojo, *Deregulation of the Argentine Economy*, FUNDACIÓN MEDITERRÁ-NEA NEWSL. (Banco de la Nación Argentina), Sept. 1992, at 3.

46. WORLD BANK, *supra* note 26.

activities.⁴⁷

Before the Menem government's free-market policies could take effect, however, the government had to survive the immediate crisis. Hyperinflation struck again in October 1989. The banking system collapsed, forcing the government to declare a bank holiday in late December 1989 and early January 1990.⁴⁸ For a time, there was no functioning banking system and no effective national currency.⁴⁹ Banks were reduced to the role of acting as exchange agents for foreign currency.⁵⁰

Menem's economic team responded by substituting long-term government bonds for deposits. Accordingly, when the banks reopened, there was little for depositors to withdraw.⁵¹ The government also slashed government spending and accelerated plans to privatize state-owned industries.⁵² Privatization was extraordinarily sweeping, with sales of the telephone company (notorious as one of the worst in the world),⁵³ the national airline, television networks, electric companies, the national railway, and even 10,000 kilometers of state-owned highway.⁵⁴

The short-term result was recession without a significant reduction in inflation, which was a devastating 2,314% for consumer prices in 1990.⁵⁵ Menem's popularity suffered accordingly, dropping from a high of 80% in September 1989 to a low of 21% in March 1991.⁵⁶

In January 1991, Menem appointed as Minister of the Economy Domingo Cavallo, a Harvard-trained economics Ph.D. with a penchant for free-market policies.⁵⁷ Cavallo, in turn, pushed for, and obtained, the appointment of Roque Fernández, a dynamic University of Chicago Ph.D.

47. See *id.* The macroeconomic study mission visited Argentina from January 31 through February 14, 1989. The study was presented to the Menem Administration in July 1989. *Id.* at iii.

48. See *supra* notes 34-38 and accompanying text.

49. Magliano Interview, *supra* note 17.

50. *Id.*

51. See *supra* notes 34-38 and accompanying text.

52. See Smith, *Hyperinflation*, *supra* note 25, at 46-50.

53. See RATLIFF & FONTAINE, *supra* note 4, at 38.

54. See *Sponsorship Statement*, *supra* note 11.

55. See INTER-AMERICAN DEVELOPMENT BANK, *supra* note 2, at 29.

56. See Edward C. Epstein, *Conclusion: The New Argentine Democracy: The Search for a Successful Formula*, in *THE NEW ARGENTINE DEMOCRACY: THE SEARCH FOR A SUCCESSFUL FORMULA* 244, 253 (Edward C. Epstein, ed., 1992).

57. See Hinchberger, *supra* note 18; Norman Peagam, *Argentina: Finance Minister of the Year—A Dramatic Difference*, *EUROMONEY*, Sept. 21, 1992; *Argentina's Economy: Nearly Time to Tango*, *ECONOMIST*, Apr. 18-24, 1992, at 17. Cavallo had previously served as Foreign Minister. See Peagam, *supra*.

with similar free-market views, as president of the central bank.⁵⁸

C. *The Recovery: 1991-93*

Cavallo's master stroke, implemented in April 1991, was the convertibility program, which required that australs be backed by government holdings of gold or foreign reserves and stipulated that the central bank would stand ready to convert australs into dollars (and vice versa) at a rate of 10,000:1.⁵⁹

This program adopted the approach recommended by the World Bank in *Reforms for Price Stability and Growth*:

the Government . . . [should] maintain a fixed exchange rate against the dollar or a basket of currencies. This would provide the nominal anchor necessary to operate a successful stabilization after hyperinflation. . . . [A]n important element for success is the availability of foreign resources to provide reserves to back the new exchange regime.⁶⁰

Such a program, the World Bank observed, would "guarantee that as remonetization proceeds virtually the entire money supply will be backed by foreign reserves."⁶¹

The following year, the government obtained legislation further implementing these reforms by explicitly guaranteeing the independence of the central bank.⁶² The law grants central bank board members six-year terms, provides that they cannot be removed except for poor performance, and states that "in the creation and execution of monetary and financial policy, the central bank will not be subject to orders or instructions from the National Executive Power [*i.e.*, the President]."⁶³ The law also prohibits the central bank from granting loans to the national government,

58. See Hinchberger, *supra* note 18; Peagam, *supra* note 57.

59. To say that the reform "dollarized" the economy, however, is somewhat misleading because the domestic currency had lost almost all credibility and the economy had effectively been dollarized by the private sector due to the financial crisis of 1989-91.

60. WORLD BANK, *supra* note 26, at xviii.

61. *Id.* at 28.

62. Ley 24,144, Carta Orgánica del Banco Central de la República Argentina. Like the convertibility program, the new central bank law closely tracks the recommendations of the World Bank, which advised that Argentina should adopt legislation to:

make the Central Bank directors politically independent, in the sense that, once appointed by the president and confirmed by the Congress, they might be removed only for closely defined impeachable offenses. Their terms ought to be relatively lengthy, and staggered. They would have full power to deny loan requests to any private or public agency.

WORLD BANK, *supra* note 26, at 62.

63. Ley 24,144, Carta Orgánica del Banco Central de la República Argentina, Artículos 3, 7, 9 (author's translation).

provinces or municipalities, except on security of government bonds at market prices.⁶⁴ It bars the central bank from granting any special guarantees which "directly or indirectly, implicitly or explicitly, cover obligations of financial entities, including depository institutions."⁶⁵ Further, the law prohibits the central bank from providing temporary liquidity assistance to financial institutions for periods of more than thirty days or for an amount greater than the institution's capital. The law also requires that any such temporary liquidity assistance be backed by adequate security.⁶⁶

The law of convertibility and related reforms appears to have sparked an astonishing economic turnaround. Argentina's stock market quadrupled in 1991.⁶⁷ Inflation fell precipitously and has remained low since; the inflation rate for 1992 was a mere 17.5%.⁶⁸ The economy has boomed, with GDP growing 9% in 1992.⁶⁹ Argentines who had socked away \$50 billion or more overseas in order to avoid the chaos at home began to repatriate their funds.⁷⁰ Argentina's country risk premium—measured by the spread between the yields on dollar-denominated Argentine bonds and LIBOR—fell from 31.9% in the first quarter of 1990 to 8.4% in the fourth quarter of 1992.⁷¹ International agencies showered the nation with credits and investment bankers flocked to Buenos Aires to solicit deals.⁷² Cavallo was widely hailed as a hero and became in the process more popular than his boss, Menem—an astonishing feat for an Argentine finance minister.⁷³

Argentina currently continues on the path toward free markets and economic prosperity. But there are potential problems ahead. The law of

64. Ley 24,144, Carta Orgánica del Banco Central de la República Argentina, Artículo 19(a).

65. Ley 24,144, Carta Orgánica del Banco Central de la República Argentina, Artículo 19(k) (author's translation).

66. Ley 24,144, Carta Orgánica del Banco Central de la República Argentina, Artículos 17(b-c), 19(d).

67. During 1991, the Argentine stock market was the world's top performer, returning more than 400% to dollar-based investors. See *Argentina: Capital Markets Steam Ahead*, EUROMONEY, Feb. 14, 1992 (Supp.).

68. Nathaniel C. Nash, *A New Rush into Latin America*, N.Y. TIMES, Apr. 11, 1993, § 3, at 6. See *Economic Indicators*, FUNDACIÓN MEDITERRÁNEA NEWSL. (Banco de la Nación Argentina), Sept. 1992, at 4.

69. Nash, *supra* note 68.

70. See Paul Hannon, *Argentina: A New Spirit of Confidence*, EUROWEEK, Sept. 5, 1992.

71. FUNDACIÓN MEDITERRÁNEA NEWSL., March 1993, at 2.

72. See Hannon, *supra* note 70.

73. See Hinchberger, *supra* note 18.

convertibility, depending as it does on a pegged exchange rate with the dollar, does not appear viable in the long run. The law's strength is also its weakness; it is vulnerable to a run to the dollar in the event that economic agents lose confidence in the central bank's ability—or willingness—to support the peso (which replaced the hyperinflated australs) by exchanging dollars for pesos at the pegged one-to-one rate. Whether the central bank will be able to support the peso if Argentina suffers continuing balance of trade deficits is not clear.

III. ANALYSIS

A. *Argentina's Constitutional Moment*

The reform in Argentina was possible because of the extraordinary political circumstances under which it was adopted. These circumstances amounted to what Bruce Ackerman has termed a “constitutional moment”⁷⁴—a time in which the ordinary politics of interest group rivalry give way, temporarily at least, to a national consensus in favor of fundamental reform. Following Ackerman, I use the term “constitutional moment” without implying that any change occurred in the written constitution—in the case of Argentina between 1989-91, none did.⁷⁵ But the events of those years were so profound and wrenching for the people of Argentina, and the changes introduced by the Menem administration so deep-seated, that the reforms were constitutional in a functional sense; Argentine politics have been fundamentally altered, and the basic role of government profoundly revised, as a result of the events of 1989-91.

This recent constitutional moment was arguably the third such event in the history of twentieth-century Argentina. Earlier fundamental change occurred in 1930, when the military displaced the democratically elected President, Hipólito Yrigoyen and replaced the previous policies of free-trade and open markets with high tariff barriers and state sponsorship of domestic industry.⁷⁶ The 1930 coup represented a shift away from the path of development that Argentina had followed theretofore, which was generally in line with that of liberal democracies such as Canada, in favor

74. See Ackerman, *Storrs Lectures*, *supra* note 13.

75. Similarly, Ackerman argues that the New Deal period constituted a constitutional moment for the United States, even though no formal amendments were added to the U.S. Constitution during this period. See *id.*

76. See generally LUIGI MANZETTI, *THE INTERNATIONAL MONETARY FUND AND ECONOMIC STABILIZATION: THE ARGENTINE CASE* 26 (1991).

of antidemocratic, authoritarian rule with pervasive state involvement in markets.

The other constitutional moment of recent history, prior to the events of 1989-91, was the rise of Juan Perón in 1945-46. Perón's policies created an Argentine corporatist state in which the government attempted to control the economic system through nationalization of major industries and through partnership with politically-favored, state-sponsored interest groups enjoying a monopoly of political power in their fields of endeavor.⁷⁷ The distinctive feature of the Peronist constitutional moment was the institutionalization of powerful interest groups, especially organized labor, as rent-seeking organizations with the status of *de facto* participants in the process of government.

Argentina's constitutional moment of 1989-91 represents a rejection of each of its two prior moments of this century—the state economic control and authoritarian government established in 1930⁷⁸ and the corporatist state created by Perón in 1946—and a return, in a sense, to the system of democracy, open markets, and private ownership that had characterized Argentina during its days of spectacular economic success between 1864 and 1930.⁷⁹

How did the constitutional moment of 1989-91 come to pass? As already noted, the events of the preceding years had been wrenching nearly beyond measure. Argentina had experienced guerrilla warfare from the left, followed by authoritarian military rule and a campaign of repression that left thousands dead or “disappeared.” The military junta, in a comic-opera effort to restore national prestige, had precipitated a war with Great Britain by invading the Malvinas (Falkland) Islands, a virtually unpopulated and economically insignificant territory whose control had been in dispute for more than a hundred years.⁸⁰ Argentine forces suffered a humiliating drubbing; the defeat discredited the military both as a fighting force and as a capable government. The sense of national pride for which Argentines are famous throughout Latin America suffered grievous damage.

On top of these political and military failures came the economic instability of those years which culminated in the hyperinflation of 1989-

77. See *supra* notes 26-28 and accompanying text.

78. In fairness, Raul Alfonsín deserves much of the credit for dismantling the commitment to authoritarian rule which existed to one degree or another between 1930 and Alfonsín's presidency.

79. See MANZETTI, *supra* note 76, at 25-28.

80. For a muckraking account, see JIMMY BURNS, *THE LAND THAT LOST ITS HEROES: THE FALKLANDS, THE POST WAR AND ALFONSÍN* (1987).

91. Hyperinflation demonstrated the failures of the Argentine economic system to all who lived through those times.⁸¹ It eroded morale and tore the social fabric.⁸² Every petty detail of life was affected: merchants could not put price tags on goods; customers could not comparison shop; vending machines could not function; store credit was difficult to obtain and mortgages out of the question; and prices of everyday goods and services had to be reset or renegotiated on a weekly or even daily basis. Across-the-board price increases were announced over supermarket public address systems while shoppers were in the stores. Everyone sought ways to unload their domestic currency, either by fleeing to goods—leading to excessive purchases and hoarding—or by acquiring and holding scarce foreign currencies, especially U.S. dollars. The costs of the special-interest subsidies and protections that had been such a hallmark of Argentine politics came home to ordinary citizens in the form of devastating losses and anxieties.

By 1989, the concatenation of these difficulties readied the Argentines for fundamental change. The constitutional moment which began in that year had two parts: one political and one economic.

The political change was symbolized by the passage of authority from Alfonsín to Menem. For the first time in sixty years, Argentina's democratic institutions had withstood the ultimate test—the peaceful transfer of power from one democratically elected leader to another democratically elected leader of a different political party. Alfonsín had worked during his presidency to re-establish a rule of law in Argentina after the period of military rule. Alfonsín's willingness to cede power to a rival epitomized the contribution which he and his government made to Argentine political traditions—ironically, cementing his place in Argentine history at a moment of political failure.

The events of 1989 arguably demonstrate a commitment on the part of the Argentine system to democratic institutions and a repudiation of the authoritarian style which had become synonymous with Argentine political culture after the military coup of 1930. The growth of truly democratic institutions is still fragile, however, and it may be premature to confidently label the new dispensation a constitutional moment. Nevertheless, the movement toward liberal democracy and away from authoritarian rule

81. The following description is based on interviews with Argentines who experienced the hyperinflation period.

82. For a firsthand account of some of the problems of coping with the Argentine hyperinflation, see WYNIA, *supra* note 24, at 3-15.

appears sufficiently well-established to justify that description, at least provisionally.

The other half of Argentina's constitutional moment of 1989-91 was the dramatic movement toward free markets and the repudiation of the corporatist economic policies most closely identified with Perón. If credit for reforming the authoritarian strain in Argentine politics goes to Alfonsín, credit for dismantling the corporatist state must go to Menem. Alfonsín and Menem have in effect jointly participated in the creation of a capitalist, liberal democracy.

Although Menem did not spell out his economic programs during his presidential campaign, and, therefore, his election was not itself a popular mandate for economic liberalization, a remarkable popular consensus appears to have developed after the fact in favor of his experiment in radical deregulation and privatization. This is not to say that all the reforms were popular—certainly, much of the labor movement opposed the privatizations and others experienced losses as a result of the wrenching shift to market-based policies.⁸³ Menem's popularity sank when his reforms did not generate immediate results.⁸⁴ However, no program as radical as that instituted by Menem would be popular in all circles. The essence of the matter is that the country acquiesced in the radical changes, and that it is unlikely in the future to revert to the old style of politics unless some other equally devastating political and economic crisis strikes.

B. Strategies for Precommitment

The events of 1989-91 will qualify as a true constitutional moment in Argentine history if the changes identified with those years persist over a substantial period of time. However, the survival of these changes will be challenged by short-term pressures. Politically, the military or other groups may attempt to subvert the democratic process if they believe that their interests are better served by a return to authoritarian rule. Economically, the still-powerful interest groups which benefitted from the corporatist state may seek to undermine the process of financial liberalization and reinstate some of the old system of state ownership, subsidy, and control. These forces are likely to emerge more powerfully over time as the devastation of hyperinflation fades from popular memory, and as the recent surge in prosperity gives way, as it inevitably will, to a less favorable economic

83. See *supra* note 55 and accompanying text.

84. See *supra* note 56 and accompanying text.

climate. How can the Argentine system precommit itself to maintaining these reforms and to continuing its progress toward liberal democracy in the future?

1. The Inadequacy of Constitutional Reform

One possibility for precommitment, which would probably be first in the minds of United States citizens, is to use the Constitution in order to put certain choices outside the reach of short-term political pressures. Argentina, for example, could have adopted a balanced budget amendment that prohibited the government from spending more than it collected in revenues; or it could have constitutionalized the requirement that the central bank not issue more domestic money than its holdings of foreign reserves. Constitutional reform, however, would not have been effective in Argentina.

From a political point of view, the Argentine Constitution—modeled closely on the U.S. Constitution⁸⁵—already ostensibly precommits the nation to democratic institutions and values. The President, chosen for a six-year term by a democratically elected electoral college, acts as head of state and commander-in-chief.⁸⁶ The President cannot serve two consecutive terms.⁸⁷

The bicameral Congress consists of a Chamber of Deputies with members standing for election every four years, with half elected every two years, and a Senate with members chosen by provincial legislatures for a period of six years, with a third of that body standing for election every two years.⁸⁸ The Congress has power to enact legislation, subject to executive veto and congressional override.⁸⁹

Members of the Judiciary are appointed by the President with the approval of the Congress.⁹⁰ Justices of the Supreme Court and the lower federal courts hold office during good behavior and enjoy salary protections.⁹¹ The Supreme Court and the lower courts have jurisdiction over all

85. See RATLIFF & FONTAINE, *supra* note 4, at 6.

86. CONST. ARG. arts. 81-84, 77, 86 in CONSTITUTIONS OF THE WORLD (Albert P. Blaustein & Gilbert H. Flanz eds., 2d ed. 1993).

87. CONST. ARG. art. 77, *supra* note 86. Menem forces have been speaking of amending the Constitution to allow the President to serve a second term when his current term expires in 1995. See Hannon, *supra* note 70.

88. See CONST. ARG. arts. 36-66, *supra* note 86.

89. CONST. ARG., *supra* note 86, at arts. 67-73.

90. CONST. ARG., *supra* note 86, at art. 86, item 5.

91. CONST. ARG., *supra* note 86, at art. 96.

cases dealing with matters governed by the Constitution and the laws of the nation.⁹²

These constitutional provisions are remarkably similar to the analogous provisions in the United States Constitution. However, the Argentine Constitution has not guaranteed democratic rule. The Constitution itself contains a state of siege provision authorizing the President to suspend constitutional guarantees in case of internal disorder or foreign attack endangering the operation of the Constitution.⁹³ Beyond this, military governments have governed the country by decree, in violation of constitutional requirements.⁹⁴ Whereas the United States Supreme Court has arguably been an important mechanism for precommitment to constitutional rule,⁹⁵ the same cannot be said for Argentina's Supreme Court, which has never effectively restrained unconstitutional political action.⁹⁶

It would appear desirable for the continuation of Argentina's progress toward liberal democracy if the judiciary could be established as a central institution of constitutional government with genuine powers of judicial review. To date, that reform has not occurred. The Menem government has not worked assiduously toward establishing the autonomy or independence of the judiciary. Menem's administration has reportedly favored court-packing legislation and initiated impeachment proceedings against the Vice President of the Court, Augusto Belluscio, a political opponent.⁹⁷ Opponents of the current government claim that judicial appointments have been made for political reasons, that prosecutors have been removed when they began to call attention to governmental corruption, and that judges who objected to the government's programs have been denied jurisdiction

92. CONST. ARG., *supra* note 86, at art. 100.

93. CONST. ARG., *supra* note 86, at art. 23.

94. See, e.g., Boletín Oficial of the Republic of Argentina, November 21, 1978, in CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (Albert P. Blaustein & Gilbert H. Flanz eds, 1st ed. 1978).

95. See, e.g., *United States v. Nixon*, 418 U.S. 683 (1974) (ordering President Nixon to turn over tapes of White House conversations during Watergate affair).

96. The Argentine Supreme Court has been subject to repeated purges and political manipulation, especially during periods of military rule. See LEWIS, *supra* note 3, at 252-57. Lewis quotes a decision made by the court during the military government in 1968, to the effect that "ever since its establishment, this Court has recognized the ability of a government which is the result of a successful revolution . . . to do those things which are necessary for the accomplishment of its goals." LEWIS, *supra* note 3, at 255.

97. See *Justice Minister Resigns Over Row*, LATIN AM. REGIONAL REP.: S. CONE (Latin Am. NewsL., Ltd.) Oct. 19, 1989, available in LEXIS, Nexis Library, Nwlters File.

over important cases.⁹⁸

An independent judiciary with popular support and genuine powers of judicial review would provide valuable protection against reversion to authoritarian rule. It may be that a subsequent phase of Argentina's movement toward liberal democracy will involve the establishment of such a judiciary. This development would potentially be advantageous as a means of precommitting the political system to constitutional procedures and the rule of law generally. As yet, however, the Constitution and the judiciary, as guardians of the Constitution, do not provide realistic support for bona fide precommitment.

In the absence of judicial review, Argentina's commitment to constitutional rule can only be guaranteed by continued popular support for democratic processes. At present, such processes appear to enjoy widespread support. Nevertheless, the question whether a return to authoritarianism would be met with massive popular resistance is one that cannot now be answered with assurance.

2. *Precommitment Through Central Bank Reform*

Because, in the Argentine case, a central problem of precommitment is how to devise a system in which the government does not give way to short-term pressures to monetize budget deficits or provide economic favors to political friends, an obvious approach is to place the central bank in a position where it is not likely to engage in such behavior. The central bank, in the words of Jon Elster, "can be seen as the repository of reason against the short-term claim of passion."⁹⁹

The need for central bank reform was particularly compelling in the case of Argentina because the executive power has frequently enlisted the central bank as an agent in the executive's political agenda. Perón nationalized deposits in private banks in 1946 and again in 1973.¹⁰⁰ Even when deposits were not nationalized, the central bank was enlisted to serve state interests. It accepted discounts from banks of paper, much of it of questionable quality, issued by government enterprises in exchange for loans. Thus, the central bank indirectly financed government operations outside of the explicit budget.¹⁰¹ It also gave rediscounts to the national

98. Communication from Roberto Gargarella (Apr. 25, 1993) (on file with the author).

99. ELSTER, *supra* note 19, at 89.

100. See THOMÁS J.T. BALIÑO, THE ARGENTINE BANKING CRISIS OF 1980 36 (International Monetary Fund Working Paper WP/87/77) (on file with the author).

101. See WORLD BANK, *supra* note 26, at 55-57.

mortgage bank (Banco Hipotecario Nacional or BHC) and the national development bank (Banco Nacional de Desarrollo or BANADE), both of which existed principally for the purpose of dispensing government subsidies to favored industries or individuals.¹⁰² The central bank also assisted failing or insolvent private banks through the rediscount process.¹⁰³ The costs of this “quasi-fiscal deficit” have been enormous.¹⁰⁴

The central bank reform legislation of 1992 represents an attempt to effect a precommitment not to engage in such expenditures in the future and not to monetize the deficit by issuing new money.¹⁰⁵ There are two important aspects to this legislation. First, the governors of the central bank are given fixed, six-year terms with protections against removal during their term except for cause. This provision is clearly intended to insulate the central bank from short-term political pressures—either from the Executive, the Congress, or political parties. Arguably, it will give the central bank some power to resist the will of the President when monetary policy is at stake.

This law represents a significant reform to the earlier regime, under which the minister of the economy had the power to instruct the head of the central bank.¹⁰⁶ While it is not clear whether a central bank president will actually be able to resist political pressures to inflate the currency in the future, the protections against removal from office and the *de facto* independence that these protections grant should provide some assurance.

In addition to *increasing* central bank autonomy by insulating its board members from political control, the new law *decreases* central bank autonomy by limiting its discretion to take actions which inflate the currency, such as funding fiscal deficits or advancing liquidity assistance to shaky banks except on short terms and backed by good collateral.¹⁰⁷

These two provisions—the political independence of the central bank and the limitations on its discretion—overlap in the sense that if political actors exert pressure against the head of the central bank to monetize the deficit or to provide special financial assistance to favored groups, the central bank president can argue that he or she is prevented by law from complying with

102. WORLD BANK, *supra* note 26, at 57.

103. *Id.*

104. Letter from Dr. Augusto C. Magliano to Geoffrey P. Miller (Apr. 13, 1993) (on file with author).

105. For a description of the legislation, see *supra* notes 62-66 and accompanying text.

106. Interview with Dr. José Luis Machinea (Dec. 1992).

107. See *supra* notes 64-66 and accompanying text.

such requests. Again, this form of precommitment would be more effective if the Argentine Judiciary possessed greater powers to block illegal government action. Increased judicial power would tend to lend credibility to the central bank's claim that its hands are tied in a given case. Nevertheless, the presence of binding legal constraints provides an additional level of protection against inflationary policies by the central bank in the service of short-term political objectives.

3. *Precommitment Through Market Discipline*

Perhaps the most unusual device for precommitment found in the Argentine constitutional moment of 1989-91 is the mechanism of deliberate precommitment through market discipline.¹⁰⁸ The underlying philosophy of this device appears to be that government can be made more reliable and more efficient if it, like institutions in the private sector, is subjected to the discipline of the private marketplace. In the case of the central bank, the government deliberately rendered the bank subject to runs by private parties in the event the government failed to fulfill its promise to provide a stable currency.

The specific mechanism for accomplishing this market discipline was the convertibility program under which the government promises to maintain a fixed, one-to-one exchange ratio between the U.S. dollar and the Argentine peso. This program can be seen as an extraordinary gamble in which the government backs its commitment to maintain monetary discipline by deliberately rendering itself vulnerable to a *golpe de mercado*. To run the peso, it was no longer necessary to go into foreign exchange markets. Anyone could convert pesos to dollars through the banking system.

Moreover, the government's commitment to maintain the value of the peso is embodied in a law that requires the central bank to fulfill its commitment even if doing so exhausts its foreign reserves. The central bank is required to maintain enough foreign reserves to ensure that it can fulfill its commitment even if the entire monetary base of domestic currency were converted into dollars. These provisions effectively prevent the government from engaging in deficit financing to any significant extent even if it wanted to do so.¹⁰⁹ By deliberately exposing itself to rigorous

108. See generally, ABRA Interview (Dec. 1992).

109. These provisions also supported the government's promise not to bail out depositors in failed or failing banks. See Miller, *supra* note 12.

market discipline, the government assured the world financial market that it would carry forward its promises to stabilize the currency.

The convertibility law appears to have successfully assured markets that the government would exercise restraint in its conduct of monetary policy.¹¹⁰ Investment has flooded into the country and inflation has remained very low by historical Argentine standards. As a precommitment device, the law appears to have been brilliantly conceived.

The convertibility plan, however, is not a panacea for Argentina's economic problems. By tagging the peso at a fixed, one-to-one exchange rate with the dollar, the convertibility plan has stabilized the currency, but at the cost of overvaluing the peso relative to the dollar.¹¹¹ Argentina went from a trade surplus in 1991 to a \$2.5 billion trade deficit in 1992.¹¹² Over time, the overvaluation of the peso may lead to political unrest as workers, managers, and owners of export industries find it difficult to survive economically.

Further, persistent overvaluation may lead to a continued flight away from pesos toward dollars which can only be counteracted by high nominal interest rates on peso deposits. As previously noted, the rates on peso deposits over the past few years have been higher than the rates on dollar-denominated deposits even though pesos and dollars are now convertible on a one-to-one basis.¹¹³ The higher peso rates suggest that the market is demanding a premium for keeping funds in pesos. This, in turn, reflects the perceived risk that the government will devalue the peso by altering the convertibility ratio or even abandoning convertibility altogether. If the holders of peso deposits lose confidence in the government's commitment to maintain convertibility, a run to dollars is not out of the question.¹¹⁴

110. See *supra* notes 67-73 and accompanying text.

111. See Hannon, *supra* note 70.

112. See *Currency Hotline: Argentine Peso*, BUSINESS INT'L MONEY REPORT, Mar. 1, 1993, available in LEXIS, Nexis Library, ALLWLO file.

113. See Hannon, *supra* note 70.

114. The danger is illustrated by current central bank President Roque Fernández's analysis of the problems under the earlier regime of 1989-90, when the government pledged to peg australs to dollars at a fixed rate and interest rates on australs were extremely high by world standards. Fernández writes:

Even the most naive of depositors knew that the situation could not last long, and at a given point of time would consider it reasonable to convert Austral deposits to US dollars. In a few months a few smart depositors could realize in Argentina a gain that would take almost a decade to obtain in the world financial market. Of course, not all could realize such a gain. It was the attempt of many to capitalize such a gain [that] promoted a run on the financial system leading to hyperinflation. I believe that this is the most simple and more powerful explanation of the hyperinflations of 1989

Roque B. Fernández, *Exchange Rate Policy and Hyperinflation*, Junio 1990 (unpublished manuscript https://openscholarship.wustl.edu/law_lawreview/vol71/iss4/12)

The potential weaknesses in the convertibility program were illustrated in November 1992 when unfounded rumors about Cavallo's possible resignation sparked a flight to dollars.¹¹⁵ The government stemmed the panic by selling foreign reserves, thus increasing the supply of dollars relative to pesos and restoring approximate parity between the currencies. However, the events reinforced public concerns about the fragility of the reforms.

Financial markets are aware of the risks in the convertibility law.¹¹⁶ Thus, beneficial as the reforms have been to date, there is no guarantee that conditions will not deteriorate in the event that markets lose confidence in the government's commitment to convertibility. Although leading government officials lose no opportunity to reassure the public that devaluation will not occur,¹¹⁷ Argentine governments have broken promises of this sort in the past and the people cannot yet rest assured that the current stability will last for a sustained period.

IV. CONCLUSION

Argentina is a land of extraordinary contrasts: Spanish-speaking, yet with a majority population of Italian descent; a New World country that identifies more with Europe than with the Americas; land of rugged individualism, yet a tradition of state terror; nationalistic to a fault, yet fundamentally insecure about its place on the world scene. Thus, it is ironic, but perhaps not surprising, that one of the most radical economic transformations of recent times should have been engineered by the very party which had instituted most of the failed policies that are now being swept away.

While Argentina's constitutional moment of 1989-91 is unprecedented in many ways, it nevertheless represents as much a part of the Argentine tradition as the excesses, corruption, and statist policies that it replaced. Almost exactly a century earlier, in 1890, Argentina, crippled by unbridled public spending, patronage, and deficit financing, defaulted on its massive

on file with the author).

115. *Run on Peso Forces New Reforms in Argentina*, BUS. LATIN AM., Nov. 23, 1992, available in LEXIS, Nexis Library, ALLWLO file.

116. See, e.g., Interview with Ricardo Anglés (Dec. 21, 1992).

117. See, e.g., *A Market Economy is the Best Option*, Interview with Finance Minister Domingo Cavallo, FUNDACIÓN MEDITERRÁNEA NEWSLETTER (Banco de la Nación Argentina), April 1993, at 6 ("[t]he peso-dollar exchange rate has been on a par for two years and I take this opportunity to refute yet again all rumors of devaluation.")

foreign debt and fell into economic chaos.¹¹⁸ The banking system collapsed and many banks failed. The government was forced to lay off workers and slash spending on public projects. Charged with responsibility to rectify the situation, Carlos Pellegrini cut back government spending, renegotiated the country's foreign debt, and reorganized its banking system. The Banco de la Nación Argentina, created by these reforms, was explicitly denied the power to lend money to the state or to issue money beyond the value of its gold reserves.¹¹⁹

A century later, Carlos Menem, Domingo Cavallo and Roque Fernández would replicate many of these reforms—renegotiating the foreign debt, downsizing the government, prohibiting the central bank from issuing money beyond its reserves, and barring the central bank from lending money to the state. Pellegrini's reforms sparked an era of prosperity and stability in Argentina that lasted more than a generation.¹²⁰ Those who care about the future of Argentina—whatever their political affiliation—can only hope that the reforms of Menem, Cavallo and Fernández enjoy at least equal success.

118. See LEWIS, *supra* note 3, at 28.

119. See *id.*

120. See *id.*